STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**4/23/02**	Bill No:	**AB 2073**
Tax:	**Property**	Author:	**Canciamilla**
Board Position:		Related Bills:	**AB 81 (2001)**

BILL SUMMARY

This bill would, with respect to certain electric generation facilities, ensure that a county would continue to be allocated the same share of property tax revenue from the facility, if it is subsequently annexed into a city's boundaries.

ANALYSIS

Current Law

Under existing law and regulations, some electrical generation facilities are assessed by the Board of Equalization (i.e., "state assessed") while others are assessed by local county assessors (i.e., "locally assessed"). The allocation of property tax revenues from property differ depending upon whether it is state or locally assessed. Generally, property tax revenues from locally assessed property are allocated by the situs of the property and accrue only to the taxing jurisdictions in the tax rate area[1] where the property is located. In contrast, for state assessed property, incremental growth in property tax revenues after 1987 is placed in a pool and shared with nearly all governmental agencies in a county according to a statutory formula.

The Board of Equalization recently amended a regulation, Property Tax Rule 905[2], which will transfer certain electrical generation facilities from local to state assessment commencing on January 1, 2003.

Proposed Law

This bill would, in part, add Section 100.8 to the Revenue and Taxation Code to provide that if a city annexes territory containing an electric generation facility previously in the unincorporated area of the county, the county would continue to be allocated the same portion of property tax revenues derived from that facility.

[1] A tax rate area is a grouping of properties within a county wherein each parcel is subject to the taxing powers of the same combination of taxing agencies.

[2] The Office of Administrative Law approved amendments to Property Tax Rule 905 on May 14, 2002.

Background

Assessment of Electrical Generation Facilities

Section 19 of Article XIII of the California Constitution provides that "[t]he Board shall annually assess * * * property, except franchises, owned or used by regulated railway, telegraph, or telephone companies, car companies operating on railways in the State, and companies transmitting or selling gas or electricity." Differences in opinion have been expressed as to whether this means that the assessment jurisdiction of the Board extends to any company that transmits or sells electricity or only "regulated" companies. Any property subject to property tax that is not within the Board's jurisdiction, or where the Board declines to assert jurisdiction, is subject to property tax assessment by the local county assessor.

Deregulation. Local county assessors have historically assessed all electrical generation facilities except those owned by the regulated public utilities. For instance, county assessors have always assessed co-generation facilities as well as facilities using renewable sources of energy such as wind or solar. Since 1999, county assessors additionally assumed the assessment of power plants divested by regulated public utilities as well as newly constructed power plants built by private companies post-deregulation. The transfer of assessment jurisdiction of divested plants was a result of a Board regulation, Rule 905, as discussed below. The Board maintained, and continues to assess, generation facilities still owned by public utilities (primarily hydroelectric and nuclear facilities.) However, beginning in 2003, the Board will reassert its jurisdiction over divested electrical generation facilities as well as certain newly constructed facilities, as noted below.

Local Assessment of Electrical Generation Facilities From 1999 to 2002: *Transfer of divested power plants from state to local assessment and local assessment of future newly constructed facilities.* As a result of electrical deregulation, 22 electrical generation facilities previously owned by public utilities were sold to private companies. As an additional consequence of deregulation, it was anticipated that non-public utility companies would construct future generation facilities. Because of these developments, the Board decided to examine the question of the boundaries of its assessment jurisdiction over companies selling electricity in a post-deregulation era.

Formal discussion of assessment jurisdiction began in November of 1998 and a series of Board hearings and interested parties meetings were held. Following a public hearing on July 29, 1999, and after accepting and publishing proposed amendments, the Board, on September 1, 1999, adopted Rule 905, *Assessment of Electric Generation Facilities*. Rule 905 was approved by the Office of Administrative Law, and became effective on November 27, 1999.

Property Tax Rule 905, provided that electrical generation facilities will be state assessed only if:

(1) "the facility was constructed pursuant to a certificate of public convenience and necessity issued by the California Public Utilities Commission to the company that presently owns the facility; or,

(2) the company owning the facility is a state assessee for reasons other than its ownership of the generation facility or its ownership of pipelines, flumes, canals, ditches, or aqueducts lying within two or more counties."

In practical application, this generally limited state assessment of electrical generation facilities to those owned by rate regulated public utilities, such as Pacific Gas and Electric Company. Consequently, after this regulation was adopted, the jurisdiction to assess the 22 conveyed electrical generation facilities was transferred from the Board to the local assessors in the counties in which the facilities are located.

State Assessment of Electrical Generation Facilities Commencing in 2003: ***Transfer of divested power plants and newly constructed plants from local to state assessment in 2003.*** In mid-2001, certain changed conditions and developments in the electric energy industry on a statewide basis, as well as the experience of two years of application of the existing Rule 905, led the Board to re-consider its 1999 decision regarding their assessment jurisdiction pursuant to Article XIII, Section 19. Among those facts and developments were: the bankruptcy of the Power Exchange in January 2001; the rolling blackouts that were required to match the supply of electricity to the demand; the fluctuation in prices being charged for electrical power in the market place; the execution of long term contracts between the State Department of Water Resources and some 22 power suppliers; the creation of the California Consumer Power and Conservation Financing Authority; the bankruptcy of Pacific Gas and Electric Company and the financial difficulties of other regulated electrical utilities. It was widely stated in the press and elsewhere that the assumptions about the effect of restructuring on the electric power market - assumptions on which the original deregulation legislation and Rule 905 were founded - were largely incorrect. The Board determined that central assessment of these generation facilities by the Board would more appropriately reflect the assessment jurisdiction given to the Board under the Constitution, and more accurately reflect the value of generation facilities on a statewide basis in the competitive power market.

Therefore, on November 28, 2001, the Board amended Rule 905 and on May 14, 2002, the Office of Administrative Law approved the amendments to the rule. Under the amendments to Rule 905, certain facilities, currently locally assessed, will become subject to state assessment on January 1, 2003. Those facilities will include the 22 divested plants plus an estimated 19 newly constructed post-deregulation plants.

Revised Property Tax Rule 905 provides that commencing with the 2003 assessment year, an electric generation facility shall be state assessed property only if:

(1) "the facility has a generating capacity of 50 megawatts or more; and

(2) is owned or used by a company which is an electrical corporation as defined in subdivisions (a) and (b) of section 218 of the Public Utilities Code; or, the facility is owned or used by a company which is a state assessee for reasons other than its ownership of the electric generation facility or its ownership of pipelines, flumes, canals, ditches, or aqueducts lying within two or more counties.

Property Tax Rule 905 excludes from the definition of "electric generation facility" a qualifying small power production facility or a qualifying cogeneration facility within the meaning of Sections 201 and 210 of Title II of the Public Utility Regulatory Policies Act of 1978 (16 U.S.C. §§796(17), (18) and 824a-3) and the regulations adopted for those sections under that act by the Federal Energy Regulatory Commission (18 C.F.R. 292.101-292.602).

Property Tax Revenue Allocation

Prior to Proposition 13, each local government with taxing powers (counties, cities, schools, and special districts, etc.) could levy a property tax on the property located within its boundaries. Each jurisdiction determined its tax rate independently (within certain statutory restrictions) and the statewide average tax rate prior to Proposition 13, under this system, was 2.67 percent. After Proposition 13, the property tax rate was limited to a maximum of one percent of a property's assessed value.

Since local jurisdictions could no longer set their own individual tax rates and instead were required to share in a pro rata portion of the maximum one percent tax rate, the Legislature was given the authority to determine how the property tax revenue proceeds should be allocated. The legislation that established the current property tax allocation system, found in Revenue & Taxation Code §95 - §99.2, was Assembly Bill 8 (Stats. 1979, Chap. 282; L. Greene). The descriptive term for the allocation procedure for locally assessed property tax revenues is still commonly referred to as "AB 8," some twenty years later.

In addition to establishing allocation procedures, AB 8 also provided financial relief to local agencies to offset most of the property tax revenue losses incurred after Proposition 13. AB 8 provided relief in two ways: first, it reduced certain county health and welfare program costs and, second, it shifted property taxes from schools to cities, counties and special districts, replacing the school's lost revenues with increased General Fund revenues. (There were six counties - Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity – referred to as "negative bailout" counties, where the amount of property taxes allocated to the county was *reduced* because the health and welfare components of AB 8 were so favorable to those counties.)

In 1992, the Educational Revenue Augmentation Fund (ERAF), was established. ERAF partially reversed the relief provided to local agencies by AB 8. The effect of ERAF was to redirect a portion of property tax revenues previously allocated to cities, counties, and special districts to schools, thus reducing the state's General Fund obligations for funding schools under Proposition 98.

Additional information on these property tax allocation procedures can be obtained from various publications authored by the Legislative Analyst's Office (LAO) and available online at http://www.lao.ca.gov.

Allocation Generally

- "Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes", LAO Report, February 2000
- "Property Taxes—Why Some Local Governments Get More Than Others", LAO Policy Brief, August 1996
- "Why County Revenues Vary: State Laws and Local Conditions Affecting County Finance", LAO Report, May 1998

Allocation and ERAF

- "Reversing the Property Tax Shifts", LAO Policy Brief, April 1996
- "Property Tax Shift", Perspectives and Issues (pp. 203 - 213), February 1997
- "Improving Incentives for Property Tax Administration", Perspectives and Issues (pp. 215 - 226), February 1997
- "Major Milestones: 25 Years of the State-Local Fiscal Relationship", California Update, December 1997
- "Shifting Gears: Rethinking Property Tax Shift Relief", LAO Report, February 1999

Locally Assessed Property. Generally, property tax revenues from locally assessed property are allocated by the situs of the property and accrue only to the taxing jurisdictions in the tax rate area where the property is located. A tax rate area is a grouping of properties within a county wherein each parcel is subject to the taxing powers of the same combination of taxing agencies.

State Assessed Property. Under current law, the allocation procedures for property tax revenues derived from state assessed property are different than those for locally assessed property. The revenue allocation system for state assessed property was established by legislation enacted in 1986 via AB 2890 (Stats. 1986, Chap. 1457). Prior to the 1988-89 fiscal year, the property tax revenues from state and locally assessed property were allocated in the same manner – by tax rate area. However, the process of identifying property according to tax rate area had become overwhelming for state assessees. As a result, AB 2890 was enacted to simplify the reporting and allocation process for state assessees except railroads. It allowed state assesses to report their unitary property holdings by county rather than by individual tax rate area. It additionally allowed the Board to allocate unitary value by county rather than by tax rate area. This change allowed state assessees to receive only one tax bill for all unitary property per county. Previously, each state assessee received hundreds of property tax bills from each county where they owned unitary property because a separate tax bill was prepared for each tax rate area where unitary property was physically located. (Statewide there are nearly 58,000 tax rate areas.)

Essentially, AB 2890 established a prescribed formula, performed by the county auditor. The results of AB 2890 are as follows:

- Preserves each local agency's tax base (hereafter called the "unitary base") for any jurisdiction which had state assessed property sited within its boundaries in the 1987-88 fiscal year.
- Thereafter, annually increases each local agency's "unitary base" by two percent (provided revenues are sufficient).
- If, after the county auditor distributes to each local agency its "unitary base" plus two percent, there is any property tax revenue remaining, then this surplus revenue, referred to as "incremental growth," is distributed to all agencies in the county. Agencies with unitary bases also receive a share of the incremental growth.
- "Incremental growth" revenues are shared with all jurisdictions in the county (i.e., county-wide distribution) in proportion to the entity's share of property tax revenues derived from locally assessed property.
- It is often stated that all state assessee revenue is shared "county-wide," but this is not technically true. In essence, it is only incremental growth that is distributed "county-wide" without regard to where the growth in value took place or where new construction occurred.
- By establishing unitary bases, jurisdictions were held harmless by the allocation system established by AB 2890 and some jurisdictions (those that had little or no state assessed property located in their jurisdictional boundaries prior to AB 2890) have since benefited from the county-wide system established for sharing the incremental growth.

Special Situations; Local Agencies Created After 1988 and ERAF.

Local agencies that did not exist prior to 1988, which would include ERAF, have a unitary base of *zero*.

- These local agencies may, however, still receive a share of state assessee revenues. However, their share would consist only of a portion of the county-wide incremental growth pool, if any, since they have no "unitary base."
- Once a local agency is granted a portion of the county-wide pool, it is thereafter annually guaranteed some amount of state assessee revenues.
- In some instances, local agencies and *ERAF receive no property tax revenues* from state assessed property. This occurs when:
    - The local agency was not in existence prior to 1988 and;
    - Since the local agency's formation, there has not been a year when there were sufficient revenues to give those local agencies that received property tax revenues in the prior year their previous year's share plus two percent.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in order to ensure that counties that have made the decision to approve the construction of an electrical generation facility will continue to receive the property tax revenues if a city within that county subsequently annexes the property into its boundaries. In the specific instance giving rise to this bill, the County of Contra Costa is concerned that a city could in the future annex territory containing an electrical generation facility and thereby "appropriate" the property tax revenue proceeds from the facility.

2. **Amendments.** As introduced, this bill would have required county assessment of certain electric generation facilities. By requiring that these facilities be locally assessed, this would have ensured that property tax revenue proceeds would be distributed only to those taxing agencies in the tax rate area where the property is physically located. These provisions have been deleted from this bill.

3. **As a result of recent amendments to Property Tax Rule 905, assessment jurisdiction over certain facilities will transfer from local to state assessment in 2003.** Without further legislation, property tax revenues from these plants will be distributed according to the county-wide system. However, AB 81 is pending in the Legislature and, if approved and signed by the Governor, then AB 81 would preserve situs based revenue allocation for these facilities.

4. **If the county-wide system of revenue allocation applies to the electrical generation facility in question, then this bill would have little practical effect since the property tax revenue would be treated as "incremental growth" to be shared with all local governments in the county.** However, if AB 81 is approved, and situs based revenue allocation is adopted for certain electrical generation facilities, then this bill would guarantee that the county, which approved the original construction of the facility, would not lose their share of property tax revenue from the facility if a city subsequently annexed the territory.

5. **In the public hearings on Rule 905, the Board heard from many local governments that made the decision to approve the siting of new power plants based in part on the property tax revenue expectations.** While sympathetic to their concerns over the pending regulation, the Board indicated that only the Legislature can modify the laws pertaining to the allocation of property tax revenues and pledged its support for legislation that provided situs based revenue allocation of power plants assessed by the Board.

6. **Is this bill intended only to affect state assessed facilities?** As currently drafted, it appears that these provisions could apply to annexations of both state assessed and locally assessed facilities.

COST ESTIMATE

This bill has no cost impact to the Board of Equalization.

REVENUE ESTIMATE

This bill has no revenue impact; revenue allocation is a zero sum game with winners and losers.

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